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All Signal, No Noise

MARKET ANALYSIS

MNI RBA Review – July 2020

Meeting Date: Tuesday July 7 2020

Statement Release Time: 05:30 BST/14:30 AEST

Link To Statement: https://www.rba.gov.au/media-releases/2020/mr-20-17.html

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MNI POV (Point Of View): More About What It Didn’t Say, As Opposed To What It Did

In One Line: Glass Half Full, But Still Cognisant Of The Downside.

We were expecting a relatively vanilla statement alongside the Reserve Bank Australia’s latest monetary policy decision, but the outcome was even blander than our very modest expectations.

There was no surprise as the Bank left its policy settings unchanged, reaffirming its forward guidance and its pledge to act, if required.

At the time, we noted that the first skim of the statement revealed very little to rock the boat. Its assessment re: the international situation was a little more upbeat as it noted that "Leading indicators have generally picked up recently, suggesting the worst of the global economic contraction has now passed.” Although it still cautioned that "despite this, the outlook remains uncertain and the recovery is expected to be bumpy and will depend upon containment of the coronavirus."

The Bank also noted the current economic hardships, while highlighting that "conditions have, however, stabilised recently and the downturn has been less severe than earlier expected. While total hours worked in Australia continued to decline in May, the decline was considerably smaller than in April and less than previously thought likely. There has also been a pick-up in retail spending in response to the decline in infections and the easing of restrictions in most of the country."

On net this alludes to a slightly less downbeat assessment when the Bank releases its updated economic projections in early August, which falls in line with the recent guidance from senior Bank officials. Although, a wider perusal of the statement reveals that it has tipped its hat to both the realised and potential sources of risk.

The Bank also reiterated its language surrounding the likely need for fiscal and monetary stimulus for some time. The next port of call on the fiscal front will come in the form of the government’s update, scheduled for July 23. The Treasurer has confirmed that income support measures will be in play beyond September (when the integral JobKeeper and JobSeeker schemes were originally set to expire) and we await further details. On the monetary side, the RBA Governor will make his annual Anika Foundation address on July 21, the minutes from the Bank’s July decision will be released on the same day.

Back to the Bank’s July statement. There was as much, if not more, interest in what the Bank didn’t say.

There was no mention of the value of the AUD, which wasn't a shock given recent rhetoric on the matter (provided in the minutes of the June meeting) and the stability in AUD Trade Weighted Index (TWI) over the past few weeks (as per our preview), however, some market participants were still looking for the Bank to touch on the matter.

The lack of explicit commentary surrounding the COVID-19 situation in Melbourne was more of a surprise, but that may come in the minutes of the meeting and was at least partially alluded to via tweaks in the rhetoric surrounding the virus. A reminder that the government of the state of Victoria has since announced a wider spread lockdown for the metropolitan area of Melbourne, which is set to last 6 weeks.

NAB noted that “this means ~20% of the national population will be restricted from leaving their homes except for essentials, work, caregiving and exercise. The second wave of infection will see Victorian economic activity fall sharply and it will continue to lag the rest of Australia, which is continuing to ease restrictions amid low virus numbers. This will weigh on overall economic growth, Victoria makes up ~23% of Australian economic activity.” The weekly ANZ-Roy Morgan Consumer Confidence Index has already started to show the impact of the worry surrounding the matter, with the most recent reading representing an eight-week low for the series.

Ultimately, the Bank is primed to add additional stimulus through its ACGB purchasing channel, if needed, but remains comfortable with how its foray into unconventional monetary policy has panned out thus far. A reminder that it hasn’t had to purchase ACGBs since early May. Negative interest rates remain off the table, best evidenced by the continued push back from high ranking Bank officials, namely Governor Lowe and Deputy Governor Debelle.

RBA July 7 2020 MEETING STATEMENT

At its meeting today, the Board decided to maintain the current policy settings, including the targets for the cash rate and the yield on 3-year Australian Government bonds of 25 basis points.

The global economy has experienced a severe downturn as countries seek to contain the coronavirus. Many people have lost their jobs and there has been a sharp rise in unemployment. Leading indicators have generally picked up recently, suggesting the worst of the global economic contraction has now passed. Despite this, the outlook remains uncertain and the recovery is expected to be bumpy and will depend upon containment of the coronavirus. Over the past month, infection rates have declined in many countries, but they are still very high and rising in others.

Globally, conditions in financial markets have improved. Volatility has declined and there have been large raisings of both debt and equity. The prices of many assets have risen substantially despite the high level of uncertainty about the economic outlook. Bond yields remain at historically low levels.

In Australia, the government bond markets are operating effectively and the yield on 3-year Australian Government Securities (AGS) is at the target of around 25 basis points. Given these developments, the Bank has not purchased government bonds for some time, with total purchases to date of around $50 billion. The Bank is prepared to scale-up its bond purchases again and will do whatever is necessary to ensure bond markets remain functional and to achieve the yield target for 3-year AGS. The yield target will remain in place until progress is being made towards the goals for full employment and inflation.

The Bank's market operations are continuing to support a high level of liquidity in the Australian financial system. Authorised deposit-taking institutions are continuing to draw on the Term Funding Facility, with total drawings to date of around $15 billion. Further use of this facility is expected over coming months.

The Australian economy is going through a very difficult period and is experiencing the biggest contraction since the 1930s. Since March, an unprecedented 800,000 people have lost their jobs, with many others retaining their job only because of government and other support programs. Conditions have, however, stabilised recently and the downturn has been less severe than earlier expected. While total hours worked in Australia continued to decline in May, the decline was considerably smaller than in April and less than previously thought likely. There has also been a pick-up in retail spending in response to the decline in infections and the easing of restrictions in most of the country.

Notwithstanding the signs of a gradual improvement, the nature and speed of the economic recovery remains highly uncertain. Uncertainty about the health situation and the future strength of the economy is making many households and businesses cautious, and this is affecting consumption and investment plans. The pandemic is also prompting many firms to reconsider their business models. As some businesses rehire workers as demand returns, others are restructuring their operations.

The substantial, coordinated and unprecedented easing of fiscal and monetary policy in Australia is helping the economy through this difficult period. It is likely that fiscal and monetary support will be required for some time.

The Board is committed to do what it can to support jobs, incomes and businesses and to make sure that Australia is well placed for the recovery. Its actions are keeping funding costs low and supporting the supply of credit to households and businesses. This accommodative approach will be maintained as long as it is required. The Board will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band..

MNI POLICY TEAM REVIEW: RBA Leaves Rates On Hold, Downturn 'Less Severe'

By Lachlan Colquhoun

SYDNEY (MNI) - The Reserve Bank of Australia left official interest rates unchanged at a record low 0.25% Tuesday, saying the domestic economic downturn is "less severe than earlier expected."

The Bank also re-affirmed its bond buying program, which has seen it spend AUD50 to control yields on 3-year Government debt, and also recommit to its Term Funding Facility which has seen commercial banks draw around AUD$15 billion so far from the AUD90 billion available.

The RBA was not expected to move on rates or other policy measures this month, and is likely to maintain its current settings in anticipation of what might happen to the economy after September, when current fiscal stimulus from the Australian Government is scheduled to end.

--STABILISATION

In its statement accompanying the policy decision, the RBA noted that Australia's economy was going through the biggest contraction since the 1930s, but said that conditions had stabilised.

In particular, recent declines in hours worked were "considerably smaller" than in April and "less than previously thought likely."

"There has also been a pick up in retail spending in response to the decline in infections and the easing of restrictions in most of the country," the RBA said.

Nevertheless, the outlook was "highly uncertain" and this was making many households and businesses cautious and to that end, the Bank said accommodative policies will be maintained for as long as required.

The Board met in Sydney as second city Melbourne went into a wider lockdown with a new spike in coronavirus infections.

ANALYSTS' KEY COMMENTS

ANZ:

- The RBA made no specific mention of Melbourne's rising COVID-19 cases, new boarder restrictions or the risk of further lockdowns.
- The RBA was upbeat about the stabilisation of the labour market, including total hours worked, which it said declined less than expected. It also noted the pick-up in retail spending since restrictions in most of the country had eased. But it countered these observations with several mentions of the "uncertainty" caused by COVID-19 and its consequences. No doubt, the possibility of restrictions on metro Melbourne being reimposed formed part of the reason for that commentary.
- On the global economy, the RBA shifted its commentary from "is experiencing" to "has experienced" a severe downturn, suggesting it sees the worst of the global economic contraction has now passed.
- The RBA did not mention the appreciating Australian dollar, having also not mentioned the currency in the June, May and April statements. As we have previously noted, this is interesting to us as a rallying currency is unhelpful in such times, regardless of border closures. Incidentally, geopolitical tensions were again not mentioned.

Barclays:

- The bank confirmed it will not increase the cash rate or the yield target until progress is being made toward full employment and the bank is confident that "inflation will be sustainably within the 2-3 percent target band."
- Compared with the June statement, the RBA seems slightly more confident about its less-pessimistic outlook about the economy. The statement notes that conditions have stabilized recently and the "downturn has been less severe than earlier expected," a change from June, when it said "it is possible that the depth of the downturn will be less than earlier expected." The RBA also pointed to the pickup in retail spending in May and the smaller decline in hours worked during that month.
- We think the RBA will revise its growth forecasts upward in the Statement on Monetary Policy in August. Our forecast for the economy to contract 4% in 2020 is less pessimistic than the bank's current forecast of a 6% decline. With restrictions being eased gradually since mid-May, economic data are showing signs of revival in the domestic economy. High-frequency data, such as consumer confidence, weekly payrolls and Household Impacts Survey from the Australian Bureau of Statistics showed signs of gradual recovery in June.
- However, the RBA's tone remains cautious and it continued to state that the nature and speed of the expected recovery remain highly uncertain. The bank flagged that "uncertainty about the health situation and the future of the economy" is affecting consumption and the investment plans of households and businesses.
- We do not think the RBA is likely to make any changes to its policy and continue to expect the cash rate to remain at 0.25%. The RBA stated today that it has not purchased government bonds in more than a month, reflecting its comfort with conditions in the bond market. We think the RBA will flag increasing uncertainty and risks to recovery, considering the renewed restrictions in Melbourne, but will remain comfortable with its stance, given the signs of green shoots emerging in rest of the economy.

CBA:

- The RBA Board left monetary policy unchanged as expected.
- Uncertainty around the economic outlook was the dominant theme in the Governor's Statement.
- It's hard to disagree. Economists are having a torrid time trying to forecast the economic outlook as a whole host of unusual dynamics play out. Many traditional economic models are of little use right now as policymakers globally continue to grapple with the trade-off between limiting the spread of COVID-19 and the negative impact on the economy from restrictions on what people can and can't do. Confidence impacts spending and the news around COVID-19 has deteriorated in Victoria over the past fortnight as infections rise.

- There probably wasn't a lot more to take away from the Governor's statement. Unless there is a dramatic turn of events, the RBA meetings are likely to be low key affairs for quite some time. The cash rate will be left on hold at the effective lower bound of 0.25% for the next couple of years and the 3 year ACGB bond yield target is likely to remain in play over that time. The bottom line is that even as the economy improves there will be a large output gap. This means that there will be a significant amount of slack in the economy that will need to be eroded before monetary policy is tightened. Full employment and underlying inflation within the 2%-3% target band looks a very long way off - which means monetary policy will remain highly accommodative.
- We continue to believe that the probability of a negative cash rate in Australia is very low, particularly while Philip Lowe remains Governor. It looks crystal clear to us that unless there is a radical change of view from Governor Lowe on the efficacy of negative rates we will not see a negative cash rate in Australia.

Citi:

- As expected, the cash rate and the yield curve control target were left unchanged at 0.25% each. Moreover, the Bank reiterated its forward guidance that the accommodative approach.
- The Statement reiterated earlier comments by Governor Philip Lowe that the downturn has been less severe than the forecasts made in the May SMP. The Governor suggested that the drop in hours worked would be closer to 9% than the 20% that was initially assumed. The Statement also noted the pick-up in retail activity as restrictions eased and infections fell across the country (Victoria remains the outlier). However, the Bank noted that the recovery remains uncertain because the pandemic is causing firms to reconsider their business models and restructure operations. That said, the Bank also notes that firms will rehire workers as demand returns; we expect that on net, the economy will add jobs in Q3 after shedding almost 1 million jobs in Q2.
- We anticipate that the Bank's baseline forecasts will be upwardly revised from the relatively pessimistic assumptions in the May SMP that were based on restrictions lasting for six-months.
- The RBA's yield curve control program offers the Bank flexibility to provide additional easing if needed. The Bank's purchases of government bonds has been unchanged over the past few months, and to-date, the Bank has only purchased ~AU$50bn. This means that if there's any tightening of financial conditions, the Bank has ample room to step up and increase purchases. Moreover, we don't expect the Bank to go down the negative interest rate path given the questions around its efficacy. Instead, we believe the Bank's preferred stimulatory response would be to increase asset purchases and continue to lean on accommodative fiscal policy.
- In recent weeks, more financial institutions have tapped into the Bank's Term Funding Facility, with the total drawings to date totalling around $AU15bn. This is still significantly less compared to the use of similar facilities overseas (Europe, for example), but the Bank believes further use of its TFF is likely in the coming months. The increase use of the TFF is probably a combination of less precautionary savings in the Banking system, and perhaps early signs of increased loan demand. Consequently, we expect June's private sector credit data to show a pick-up in business lending after it fell in May.

Goldman Sachs:

- The RBA reiterated its existing forward guidance, with the RBA noting that while it hasn't need to purchase bonds for some time, it is "prepared to scale-up its bond purchases again and will do whatever is necessary to ensure bond markets remain functional and to achieve the yield target for 3-year AGS."
- On the Term Funding Facility, the RBA noted banks had continued to draw down funds, noting "total drawings to date of around $15 billion" (compared to $6bn last month) and that "further use of this facility is expected over coming months."
- Despite this apparent near-term growth upgrade, the RBA remained fairly cautious about the outlook.

HSBC:

- There were no surprises from the RBA today. The cash rate target was left unchanged at 0.25% as was the 3-year yield target. The statement noted that the RBA had not purchased government bonds for some time (the last purchase was on 6 May) but that they were prepared to scale up bond purchases again if needed to achieve the 3-year yield target.
- The RBA did not comment on the recent outbreak in Victoria. As this event has escalated only in the past few days, its economic impact is clearly still highly uncertain. It is quite typical for the RBA to consider it too early to make any specific statement about such a contemporaneous event or the likely impact it will have. The statement did note that 'uncertainty about the health situation and the future strength of the economy is making many households and businesses cautious, and this is affecting consumption and investment plans'.
- There was, once again, no sense in the RBA's comments today that there is any discussion being had about any additional steps the RBA could take -- only that the current 'accommodative approach will be maintained as long as it is required'. It's mostly fiscal from here.

J.P.Morgan:

- The decision held few surprises.
- We had expected the commentary to strike a balance between acknowledging that levels of economic activity, to this point, are above what were previously expected, while reserving some caution, given recent resumption of cases. Victoria did not get a specific mention in the commentary, but one of the few notable changes was omission of June’s statement that “the rate of new infections has declined significantly”.
- Other amendments were mostly marking to market for new numbers on cumulative job losses, and banks’ use to date of the TFF. The surprising strength of retail sales also garnered a mention, but was couched in terms of previous positive developments on the health side, particularly the earlier decline in infections and easing of restrictions. That dynamic is clearly turning now, which may be a challenge to retail spending.
- Looking beyond the very near term, the governor cited elevated uncertainty about health outcomes and the economic outlook as contributing to household and business caution, and also “affecting consumption and investment plans”. In this environment the RBA is “doing what it can”, by keeping interest servicing costs low and facilitating credit supply, but there is no particular policy action that can fill the output gap or remove spare capacity in the labour market any time soon.
- There has not been much to say in the policy space since March’s announcements, with the exception of ongoing tweaks to the RBA’s more micro market interventions. Today, Governor Lowe stated again the RBA’s willingness to buy sub-3Y bonds if needed to ensure that all such yields are consistent with the 3Y target, and also noted that further drawdown of the bank funding facility is likely in coming months.

Morgan Stanley:

- The RBA's July statement was more confident of having passed through the worst of the economic contraction, with conditions in the global economy and financial markets "improved". Domestically, the RBA flagged that the economy had performed better than forecast in Q2, with a reduction in hours worked around half what was assumed in their May forecasts.
- Tempering this better than expected performance however was an increased emphasis on the "uncertainty" of the outlook going forward (mentioned 4 times vs 1 prev.). Importantly, this was not just linked to the variance of possible outcomes, but also the negative implications on the outlook that uncertainty was having, impacting consumption and investment plans.
- The statement retained an emphasis on fiscal and monetary coordination, noting that "fiscal and monetary support will be required for some time". It also added reference to the positive impact on the labour market, noting that "many others retaining their job only because of government and other support programs".
- The final paragraph of the statement was unchanged, supporting our view that the current framework is likely to remain in place for some time. The RBA has still not purchased a bond as part of its yield target since early May, but we expect a rise in global yields will require them to re-enter the market to lean against the upward pressure during Q3. Take-up of the Term Funding Facility (TFF) by the banks has also increased, although we expect a further acceleration before the end of the initial allocation of $90bn at the end of September. The risk remains tilted towards further easing from the RBA, with a combination of economic and fiscal disappointment the most likely catalyst.

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NAB:

- As expected, the RBA kept the cash rate and 3-year yield target at 0.25%. The Reserve Bank's guidance remains the same. Elsewhere, it noted drawdowns of the term funding facility – which provides three-year funding to banks at an interest rate of 0.25% to lend to business – are at $15 billion and "further use of this facility is expected over coming months" (initial allowances under the facility are currently $116 billion).
- There are signs of gradual improvement from very weak levels. The June data should reveal the first signs of recovery in some of the jobs lost as restrictions were eased around Australia.
- But the health and economic outlook remains highly uncertain..

RBC:

- As expected, there were no changes to the RBA's cash rate, YCC, or its broader unconventional policy stance following its July board meeting today. We note, however, that the tone of the short statement was a little more cautious, with the word "uncertain" repeated four times compared with just once in June. No doubt, this likely reflects the sharply deteriorating COVID-19 situation in VIC recently, as well as the resurgence in numerous US States and continued rise in infection in a number of developing countries although these developments were not explicitly mentioned today.
- Domestic data since the board last met have, on balance, mostly been firmer – Q1 GDP, confidence, trade, retail – with the exception of the labour market. The global data trend is similar amid a varying pace of easing in restrictions. However, developments on the COVID-19 front have been less encouraging both domestically and globally, which will likely see some setback to the generally improving data trend. These developments are consistent with our view that the worst in terms of economic contraction and labour shedding is likely behind us but the recovery path will be uneven and modest, with ongoing uncertainty depending on the trajectory of COVID-19 and anti viral/vaccine developments. A further deterioration in outbreak of cases in Victoria has just resulted in Premier Andrews announcing a return to level 3 restrictions for metropolitan Melbourne and the Mitchell shire for the next six weeks. We note that Melbourne is AU's second-largest city in population and contribution to activity, with the full State accounting for almost one-quarter of total output. Metropolitan Melbourne accounts for ~3/4 of the State's population. While there will be an immediate impact on activity, more worrying is the likely hit to confidence from stop, start restrictions, which has potential to temper activity, investment, and employment more permanently.

Westpac:

- As expected, the Reserve Bank board kept its policy settings unchanged.
- We will be interested in how this more positive assessment channels into the forecasts. From a policy perspective the most interest will be in the assessment of the medium term outlook. We assess that the Bank expects it is extraordinarily unlikely to see the need to adjust policy settings in 2021.
- But recall that in its "upside scenario" in the May Statement on Monetary Policy the Bank assessed an unemployment rate of 5% by June 2022. Such an improvement in the unemployment rate would probably see it considering a move in its three year bond target at that time since it confirmed today "the yield target will remain in place until progress is being made towards the goals of full employment and inflation"..
- Growth through to December 2020 is also likely to be revised up from minus six per cent to nearer Westpac's forecast of around minus four per cent. But that will be largely offset by a considerable reduction in the 2021 growth forecast of six per cent (Westpac's forecast is three per cent). Evidence that the Bank may adjust its 2021 forecasts downwards comes through the Governor's observation that "As some businesses rehire workers as demand returns, others are restructuring their operations".
- Of considerable interest will be the Bank's assessment of the level of activity in the economy by end 2021 relative to the end of 2019.
- And, of course, bear in mind that the forecasts in May assumed an AUD at USD 0.64 over the forecast period. However, while I am sure that he would like a lower AUD there is not much point in criticising its level if he has no intention of addressing the issue through policy. Policies such as negative interest rates and/or unsterilized intervention have been variously described as extraordinarily unlikely.
- The Statement today clearly signalled steady policy except with respect to targeting the three year bond rate "will do whatever is necessary to ensure bond markets remain functional and to achieve the yield

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target for three year AGS". That statement implies that the Bank has adequate commitment to add to the AUD 40 billion it has already purchased, although only around a quarter was purchased in the two – three year maturity range. Those purchases were in a year when the Budget deficit lifted from "balance" to a deficit of (we forecast) AUD 95 billion. This year (2020/2021) we expect the deficit to balloon to AUD 240 billion, making for a more active RBA, specifically if domestic and global growth surprise to the upside or market stability falters.

- The Deputy Governor Guy Debelle seemed more flexible by ending his speech to the Economic Society last week with, "the Reserve Bank will maintain the current policies to keep borrowing costs low and credit available, and stands ready to do more as the circumstances warrant".
- Candidates for those "circumstances" range from a rampant AUD to another global crisis.